

Partnership Return of Income

(Section references are to the Internal Revenue Code (IRC) unless otherwise specified.)

World Wide Web

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<http://www.hawaii.gov/icsd/tax/taxforms.html>

Changes You Should Note

With regard to the State's audit of a partnership doing business in Hawaii and effective for taxable years beginning after December 31, 1995, Act 187, Session Laws of Hawaii 1996, now subjects a partnership to the consolidated audit procedures of sections 6221 through 6233.

Purpose of Form

Form N-20 is used to report the income, deductions, credits, gains, and losses from the operation of a partnership. Form N-20 for 1996 is an information return for the calendar year 1996 or other fiscal year beginning in 1996.

Who Must File

Every partnership unless expressly exempted shall, for its taxable year, make a return of income on Form N-20 stating specifically the items of gross income and allowable deductions, and such additional information as required below. The partnership return shall, include the income, deductions, and credits attributable everywhere together with the income, deductions, and credits attributable only to Hawaii. If the return is filed on behalf of a syndicate, pool, joint venture, or similar group which group was created on or after January 1, 1958, a copy of the agreement, together with all amendments thereto, should be attached to the return, if not already filed.

When and Where to File

The return of a partnership must be filed on or before the 20th day of the 4th month following the close of the taxable year of the partnership, with the taxation district office in which the partnership has its principal place of business. **Note:** If the due date falls on a Saturday, Sunday, or legal State holiday, the return shall be due on the next succeeding day which is not a Saturday, Sunday, or legal State holiday. Where the partnership does not have a place of business in the State, the return shall be filed with the Department of Taxation, P.O. Box 3559, Honolulu, Hawaii 96811-3559.

If you need more time to file a partnership return, file Form N-100, Application for Automatic Extension of Time to File Hawaii Return for a Partnership, Trust, or REMIC, for an automatic 3-month extension. File Form N-100 by the regular due date of the partnership return.

After you have filed Form N-100, if more time is needed to prepare the partnership return, file Form N-100A, Application for Additional Extension of Time to File Hawaii Return for a Partnership, Trust, or REMIC, for an additional extension of up to 3 months. To obtain this additional extension of time to file, you must show reasonable cause for the additional time that you are requesting. Form N-100A must be filed

before the extended due date of the partnership return.

MAILING ADDRESSES

OAHU DISTRICT OFFICE
P.O. Box 3559
Honolulu, Hawaii 96811-3559

MAUI DISTRICT OFFICE
P.O. Box 913
Wailuku, Hawaii 96793-0913

HAWAII DISTRICT OFFICE
P.O. Box 1377
Hilo, Hawaii 96721-1377

KAUAI DISTRICT OFFICE
P.O. Box 1688
Lihue, Hawaii 96766-5688

DISTRICT OFFICE LOCATIONS

OAHU DISTRICT OFFICE
830 Punchbowl Street
Honolulu, Hawaii 96813-5045
Telephone: (808) 587-6515 (Jan.-April 20)
(808) 587-4242
Toll-Free: 1-800-222-3229

MAUI DISTRICT OFFICE
State Office Building
54 High Street
Wailuku, Hawaii 96793-2126
Telephone: (808) 984-8500

HAWAII DISTRICT OFFICE
State Office Building
75 Aupuni Street
Hilo, Hawaii 96720-4253
Telephone: (808) 974-6321

KAUAI DISTRICT OFFICE
State Office Building
3060 Eiwa Street
Lihue, Hawaii 96766-1310
Telephone: (808) 274-3456

Rounding Off to Whole-Dollar Amounts

You may show the money items on the return and accompanying schedules as whole-dollar amounts. To do so, drop any amount less than 50 cents and increase any amount from 50 cents through 99 cents to the next higher dollar.

Recordkeeping

The partnership records must be kept as long as they may be needed for the administration of any provision of the federal Internal Revenue Code. Usually, records that support an item of income, deduction, or credit on the partnership return must be kept for 3 years from the date the return is due or is filed, whichever is later. Keep records that verify the partnership's basis in property for as long as they are needed to figure the basis of the original or replacement property.

Copies of the filed partnership returns should also be kept as part of the partnership's records. They help in preparing future returns and in making computations when filing an amended return.

Amended Return

If, after filing its return, the partnership becomes aware of any changes it must make to income, deductions, credits, etc., it should file an amended Form N-20 and an amended Schedule K-1 for each partner. Check the box on Form N-20 at Item I(4), page 1. Give a corrected Schedule K-1 (Form N-20) to each partner. Check the box at Item I(2) on each Schedule K-1 to indicate that it is an amended Schedule K-1.

Information Returns

Every partnership must file information returns if it makes payments of rents, commissions, or other fixed or determinable income totaling \$600 or more to any one person in the course of its trade or business during the calendar year. It must report interest payments if they total \$10 or more.

For example, if the partnership pays a person \$600 or more in any calendar year to perform services under a subcontract type of arrangement in which no employment taxes are withheld, the partnership must file federal Form 1099-MISC, Miscellaneous Income.

Use Form N-196, Annual Summary and Transmittal of Hawaii Information Returns, to summarize and send information returns to your respective taxation district office. For more information about filing information returns and exceptions, see the instructions for Form N-196.

Attachments

If you need more space on the forms or schedules, attach separate sheets. Use the same arrangement as the printed forms. **Show the totals on the printed forms.** Put the partnership's name and Federal Employer Identification Number on each sheet. Also, be sure that each separate sheet clearly indicates the line or section on the printed form to which the information relates.

To assist us in processing the return, please complete every applicable entry space on Form N-20. Do not attach statements and do not write "See attached" in lieu of completing the entry spaces on the form.

Definitions

a. Partnership. The term "partnership" includes a limited partnership, syndicate, group, pool, joint venture, or other unincorporated organization, through or by which any business, financial operation, or venture is carried on, and that is not, within the meaning of the federal Internal Revenue Code, a corporation, trust, estate, or sole proprietorship. If an organization more nearly resembles a corporation than a partnership or trust, it is considered an association taxed as a corporation.

Important factors in determining whether a partnership exists include:

1. The parties' conduct in carrying out the provisions of the partnership agreement;
2. The testimony of disinterested persons;
3. The relationship of the parties;
4. The abilities and contributions of each; and

5. The control each has over the partnership income and the purposes for which the income is used.

A joint undertaking merely to share expenses is not a partnership. Mere co-ownership of property that is maintained and leased or rented does not constitute a partnership. However, if the co-owners provide services to the tenants, a partnership exists.

Some partnerships **may be** excluded completely or partially from being treated as partnerships for federal income tax purposes upon the election of all of the members. See **Specific Instructions** below for more information.

b. General Partner. A general partner is a member of the organization who is personally liable for the obligations of the partnership.

c. Limited Partner. A limited partner is one whose potential personal liability for partnership debts is limited to the amount of money or other property that the partner contributed or is required to contribute to the partnership.

d. Limited Partnership. A limited partnership is a partnership composed of at least one general partner and one or more limited partners.

e. Nonrecourse Loan. Nonrecourse loans are those liabilities of the partnership for which none of the partners have any personal liability.

f. Limited Liability Company. A limited liability company (LLC) is an entity formed under state law by filing articles of organization as an LLC. Unlike a partnership, none of the members of an LLC are personally liable for its debts. An LLC may be classified for federal income tax purposes either as a partnership or a corporation, depending on whether it has the corporate characteristics of centralization of management, continuity of life, free transferability of interests, and limited liability. To be classified as a partnership, it may have no more than two of these characteristics. Similar rules apply to a limited liability company formed under the laws of a foreign country. Hawaii has not allowed the formation of LLCs. Act 92, Session Laws of Hawaii 1996, however, will allow LLCs to operate beginning April 1, 1997, following proper approval from the Department of Commerce and Consumer Affairs (DCCA), Business Registration Division. Hawaii nevertheless, will administratively conform to the federal standards in determining whether an LLC is classified as either a partnership or a corporation following proper approval by DCCA.

Instructions for Federal Form 1065 — Use of

In an effort to streamline Hawaii's partnership return instructions, the discussion of certain topics already discussed in the federal instructions for Form 1065, U. S. Partnership Return of Income, will not be repeated. Please refer to the federal instructions for discussions on the following topics which Hawaii conforms to:

- **Termination of the Partnership;**
- **Accounting Methods;**
- **Accounting Periods;**
- **Separately Stated Items;**
- **Elections Made by the Partnership;**
- **Elections Made by Each Partner;**
- **Partner's Dealings With Partnership;**
- **Contributions to the Partnership;**
- **Dispositions of Contributed Property;**
- **Recognition of Precontribution Gain on Certain Partnership Distributions;**
- **Unrealized Receivables and Inventory Items; and**
- **Passive Activity Limitations.**

Net Operating Loss Deduction

A partnership is not allowed the deduction for net operating losses. (See section 703(a)(2)(E).)

Signatures

General Partner

Form N-20 is not considered a return unless it is signed. One general partner must sign the return. If a receiver, trustee in bankruptcy, or assignee controls the organization's property or business, that person must sign the return.

Paid Preparer's Information

If someone prepares the return and **does not charge the partnership**, that person should not sign the partnership return.

Generally, anyone who is paid to prepare the partnership return must sign the return and fill in the other blanks in the **Paid Preparer's Information** area of the return.

The preparer required to sign the partnership's return MUST complete the required preparer information and;

- Sign it, by hand, in the space provided for the preparer's signature. (Signature stamps or labels are not acceptable.)
- Give the partnership a copy of the return in addition to the copy to be filed with your taxation district office.

Specific Instructions

These instructions follow the line numbers on the first page of Form N-20 and on the schedules that accompany it. Specific instructions for most of the lines have been provided. Those lines that do not appear in the instructions are self-explanatory.

File only one return for each partnership. Mark "duplicate copy" on any copy you give to a partner.

If a syndicate, pool, joint venture, or similar group files Form N-20, a copy of the agreement and all amendments must be attached to the return, unless a copy has already been filed. Under section 761(a), an investing unincorporated organization or one participating in the joint production, extraction, or use of property under an operating agreement or an organization of dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities may elect not to be treated as a partnership. Make the election by attaching a statement to Form N-20 for the first year for which the partnership wants the exclusion.

Fill in applicable lines and schedules.

Form N-20

Name, Address, Hawaii G.E./Use Identification Number and Federal Employer I.D. Number

The partnership may use its legal or trade name on all tax returns and other documents filed. Print or type the partnership's legal name and address on the appropriate line. Show the Hawaii G.E./Use Identification Number in item F and the Federal Employer I.D. Number in item E on page 1 of Form N-20.

Lines 1a and 1b

Enter gross receipts or sales from all business operations and returns and allowances. Do not include those you are required to report on lines 4 through 7.

For additional information, see related instructions for federal Form 1065.

Line 2

Complete Schedule A of Form N-20 if there is an entry on line 2 for cost of goods sold.

Line 4

Enter the amount shown on Form N-20, Schedule K-1, or Form N-40, Schedule K-1.

Show the other partnership's or fiduciary's name, address, and Federal Employer's Identification Number on a separate statement attached to this return. If income or loss from more than one entity is reported on this line (or is reported instead on another line or schedule of this Form N-20), show on the statement the income or loss from each.

If there is a loss from another partnership, the amount of the loss that may be claimed is subject to the limitations of sections 465 and 704(d), as appropriate.

Example: If partnership A is a partner in Partnership B, Partnership A enters on this line its share of ordinary income (loss) of B. This information should be shown on the Schedule K-1 that B issued to Partnership A.

If A's tax year does not coincide with B's tax year, include in A's return the share of the ordinary income (loss) for the tax year of B ending within the year for which A's return is filed.

Partnership A considers its share of other items separately reported on the Schedule K-1 issued by B as if the items were realized by B or incurred in the same manner as incurred by B. For example, Partnership A's share of B's capital gains (losses) should be reported on Schedule D of Form N-20, lines 4 and 9.

Line 5

Enter the net profit (loss) derived from the farm operations of the partnership. Attach federal Schedule F.

Line 6

Caution: *Include only ordinary gains or losses from the sale, exchanges, or involuntary conversion of assets used in a trade or business activity. Ordinary gains or losses from the sale, exchange, or involuntary conversion of rental activity assets will be reported separately on Schedules K and K-1, generally as a part of the net income (loss) from the rental activity. If the partner does not materially participate in the trade or business, the gains or losses reported on line 6 will be subject to the passive activity rules.*

Line 7

Enter any other taxable income and attach a detailed schedule to return. Include taxable income from annuities and insurance proceeds.

Do not include those items requiring separate computations which must be reported on Schedule K. (See the instructions for Schedule K.)

For additional information, see related instructions for federal Form 1065.

Lines 9a, 9b, and 9c

Enter salaries and wages not reported elsewhere (for example, Schedule A, line 3, and contributions to Simplified Employee Pension plans (SEP's) line 18) and reduce it by jobs credit on Schedule K, line 17.

For additional information, see related instructions for federal Form 1065.

Line 10

Deduct payments or credits to a partner for services or for the use of capital if the payments or credits are determined without regard to partnership income. Do not do this if the payments and credits should be capitalized. Do not include distributive shares of partnership profits. Report the guaranteed payments to the appropriate partners on Schedule K-1 (Form N-20), line 5.

Note: *Although payments or credits to a partner for services rendered in organizing a partnership may be guaranteed payments under section 707, they are not deductible on line 10. But they should be separately reported on Schedules K and K-1, line 5. They are capital expenditures.*

Line 11

Enter the cost of incidental repairs, such as labor and supplies, that do not add to the value of the property or appreciably prolong its life. New building, machinery, or permanent improvements that increase the value of the property are not deductible. They are chargeable to capital accounts and may be depreciated or amortized.

Do not include section 179 expense items. Report this amount on federal Form 4562, Part I, and on Schedule K, line 9.

Line 12

You may either deduct business bad debts when they become wholly or partially worthless. The Tax Reform Act of 1986 repealed the reserve method of deducting bad debts on receivables, except for small banks and thrift institutions. Effective for tax years beginning after 1986, taxpayers will have to use the specific charge-off method for receivables that become uncollectible in whole or in part.

Line 13

Enter rent paid on business property used in a trade or business activity. Do not deduct rent for a dwelling unit occupied by any partners for personal use.

For additional information, see related instructions for federal Form 1065.

Line 14

Enter taxes paid or incurred in the trade or business activities of the partnership, if not reflected in cost of goods sold. Federal import duties and federal excise and stamp taxes are deductible only if paid or incurred in carrying on the trade or business of the partnership. Taxes incurred in the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income may be considered to be deductible only under section 212. These are not deductible on line 14, but are reportable separately to the partners on Schedule K and K-1, line 11, as an itemized deduction. Do not deduct taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.), federal income taxes, estate, inheritance, legacy, succession, and gift taxes, or taxes reported elsewhere, as on federal Form 8825 or Schedule K.

Do not deduct amounts paid or accrued during the year for real property construction period taxes (other than for low-income housing). See the instructions for line 20 for information on amortizing these amounts.

Line 15

Include only interest incurred in the trade or business activities of the partnership that is not claimed elsewhere on the return.

For additional information, see related instructions for federal Form 1065.

Line 16

Enter the total amount of depreciation claimed. Complete and attach federal **Form 4562**. See federal Form 4562 and the related instructions for more information.

Do not include any expense deduction for recovery property (section 179) on this line. This amount is not deductible by the partnership. Instead, it is passed through to the partners on line 9 of Schedules K and K-1.

Line 17

If the partnership claims a deduction for timber depletion, complete and attach federal Form T, Forest Activities Schedules.

Do not report depletion deductions for oil and gas properties on this line. Each partner figures depletion on these properties under section 613A(c)(7)(D).

Line 18

Enter deductible contributions made by the partnership for its common-law employees under a qualified pension, profit-sharing, annuity, bond purchase plan, or Simplified Employee Pension (SEP) plan, and under any other deferred compensation plan. Enter payments made to these plans for partners on Schedules K and K-1, line 11.

If the partnership contributes to an Individual Retirement Arrangement (IRA) for employees, include the contribution in compensation on page 1, line 9, or Schedule A, line 3, not on line 18. Enter contributions to an IRA for a partner on Schedules K and K-1, line 11.

Line 19

Enter the partnership's contributions to employee benefit programs for common-law employees which are not part of retirement plans included on 18, such as contributions for insurance, health, and welfare programs.

Do not include any deductions allowable under the provisions of section 162(m) with respect to amounts paid during the taxable year for insurance which constitutes medical care for a partner, a partner's spouse, or partner's dependents.

For additional information, see related instructions for federal Form 1065.

Line 20**Other Deductions**

Enter any other authorized deductions related to a trade or business activity for which there is no line on page 1 of Form N-20.

For additional information, see related instructions for federal Form 1065.

Schedule A**Cost of Goods Sold**

(See related instructions for federal Form 1065.)

Line 1

Enter the beginning inventory on Schedule A, line 1. If it is different from last year's closing inventory, attach an explanation.

Line 2

Reduce purchases by items withdrawn for personal use. Withdrawals for personal use is shown in Schedules M-2 and K-1 (Item J) as distributions to partners.

Lines 4, 5 and 7

See related instructions for federal Form 1065.

Line 9

Your inventories can be valued at:

- cost,
- cost or market value (whichever is lower), or
- any other method approved by the Director of Taxation, when those methods conform with the provisions of the Hawaii Revised Statutes.

Check the method(s) used for valuing inventories on line 9a. Under "lower of cost or market," market generally applies to normal market conditions when there is a current bid price prevailing at the date the inventory is valued. When no regular open market exists or when quotations are nominal because of inactive market conditions, use fair market prices from the most reliable sales or purchase transactions that occurred near the date the inventory is valued. For additional requirements, see federal Regulations section 1.471-4.

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are "subnormal" (that is, because of damage, imperfections, shop wear, etc.) within the meaning of federal Regulations section 1.471-2(c). Such goods may be valued at a current bona fide selling price minus the direct cost of disposition (but not less than scrap value) if the taxpayer can establish such a price. See federal Regulations section 1.471-2(c) for additional requirements.

On line 9a(iv), indicate whether you used a method of inventory valuation other than those described in line 9a(i), (ii), or (iii), and attach a statement describing the method used.

If this is the first year the "Last-in First-out" (LIFO) inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method, provided in section 472, attach a statement with an explanation.

Schedule B**Additional Information Required**

Answer all questions listed in this schedule.

Question 9 - Consolidated Audit Procedures

Generally, the tax treatment of partnership items is determined at the partnership level in a consolidated audit proceeding, rather than in separate proceedings with individual partners.

Answer "Yes" to Question 9 if ANY of the following apply:

- The partnership had more than 10 partners at any one time during the tax year (for purposes of this question, a husband and wife—and their estates—count as one person); or
- Any partner was a nonresident alien or was other than a natural person or estate; or
- Any partner's share of any partnership item was different from his or her share of any other partnership item; or
- The partnership is a "small partnership" that has elected to be subject to the rules for consolidated audit proceedings. "Small partnerships" as defined in section 6231(a)(1)(8) are not subject to the rules for consolidated audit proceedings, but may make an irrevocable election under Temporary Regulations section 301.6231(a)(1)-1T(b)(2) to be covered by them.

Note: *The partnership does not make this election when it answers "Yes" to Question 9. The election must be made separately.*

If a partnership return is filed by an entity for a tax year, but it is determined that the entity is not a partnership for that tax year, the consolidated partnership audit procedures will generally apply to that entity and to persons holding an interest in that entity. See Temporary Regulations section 301.6233-1T for details and exceptions.

For more information on the rules for consolidated audit proceedings, see federal Publication 556, Examination of Returns, Appeal Rights, and Claims for Refunds.

Designation of Tax Matters Partner (TMP)

If the partnership is subject to the rules for consolidated audit proceedings in sections 6221 through 6233, the partnership may designate a partner as the TMP for the tax year for which the return is filed by completing the Designation of Tax Matters Partner section on page 2 of Form N-20. See previous discussion on consolidated audit procedures to determine if the partnership is subject to these rules.

Schedule D

Capital Gains and Losses

Purpose of Schedule.—Use Schedule D (Form N-20) to report the sale or exchange of capital assets, except capital gains (losses) that are specially allocated to any partners.

FOR DETAILED INFORMATION SEE SEPARATE INSTRUCTIONS FOR SCHEDULE D (FORM N-20).

Schedule K and Schedule K-1

Partners' Share of Income, Credits, Deductions, etc.

Purpose

Schedule K is a summary schedule of all the partners' shares of the partnership's income, deductions, credits, etc. Prepare Schedule K-1 in triplicate. A copy of each partner's K-1 must be attached to the Form N-20 filed with your taxation district office, one copy to be sent to each partner, and one copy retained for the partnership's files.

Although the partnership is not subject to income tax, the members are liable for income tax on their shares of the partnership income, whether or not distributed, and must include their share on their tax returns.

The total amount of the distributive share items (columns b and c) reported on each line on all of the partners' Schedules K-1 should equal the amount reported on the same line of Schedule K of Form N-20.

Complete Schedule K-1 for each partner. Schedules K and K-1 have the same line numbers to make it easier for the partnership to prepare Schedule K-1. In addition, Schedule K-1 has questions A thru I and item J. Additional copies of Schedule K-1 are available from your taxation district office.

Attributable to Hawaii

Each partnership must state specifically the income attributable to the State and the income attributable everywhere with respect to each partner.

Ordinary income or (loss) from trade or business activities shall be attributed to the State by the use of the apportionment of business income allocation

provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA), section 235-29, HRS. Business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three. The property factor is a fraction, the numerator of which is the average value of the partnership's real and tangible personal property owned or rented and used in this State during the tax period and the denominator of which is the average value of all the partnership's real and tangible personal property owned or rented and used during the tax period. Property owned by the partnership is valued at its original cost. Property rented by the partnership is valued (or capitalized) at eight times the net annual rental rate. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period. The use of monthly values may be required if necessary to properly reflect the average value of the partnership's property. The payroll factor is a fraction, the numerator of which is the total amount paid in this State during the tax period by the partnership for compensation, and the denominator of which is the total compensation paid everywhere during the tax period. The sales (or gross receipts) factor is a fraction, the numerator of which is the total sales of the partnership in this State during the tax period, and the denominator of which is the total sales of the partnership everywhere during the tax period.

If this apportionment does not fairly represent the extent of the partnership's business activity in this State, the partnership may request the use of separate accounting, the exclusion of one or more of the factors, the inclusion of one or more additional factors, or the use of any other method to accurately reflect the partnership's business activity in the State. Complete Schedules O and P on page 4 of Form N-20 to show this computation.

Other items are attributed as follows:

- Net rents and royalties from real property located in Hawaii are attributed to Hawaii. Federal Form 8825 may be attached to Form N-20 as a schedule of expenses.
- Net rents and royalties from tangible personal property are attributed to Hawaii if and to the extent that the property is utilized in Hawaii.
- Capital gains and losses from sale of real property located in Hawaii are attributed to Hawaii.
- Capital gains and losses from sales of tangible personal property are attributable to Hawaii if the property had a situs in Hawaii at the time of the sale.
- Interest and dividends are attributed to Hawaii if the partnership's commercial domicile is in Hawaii.
- Patent and copyright royalties are attributed to Hawaii if and to the extent that the patent or copyright is utilized by the payer in Hawaii.

How Income is Shared Among Partners

Income (loss) is allocated to a partner only for the part of the year in which that person is a member of the partnership. The partnership will either allocate on a daily basis or divide the partnership year into segments and allocate income, loss, or special items in each segment among the persons who were partners during that segment. (See section 706(c)(2) for more information and for the termination of a partner's interest.)

Allocate shares of income, gain, loss, deduction, or credit among the partners according to the partnership agreement for sharing income or loss generally. If the partners agree, specific items may be allocated among them in a ratio different from the ratio for sharing income or loss generally. For instance, if the net income exclusive of specially allocated items is divided evenly among three partners but some special

items are allocated 50% to one, 30% to another, and 20% to the third partner, report the special items on the appropriate line of the applicable partner's Schedule K-1 and the total on the appropriate line of Schedule K instead of on the numbered lines on page 1 of Form N-20 or Schedules A or D.

If the partnership agreement does not provide for the partner's share of income, gain, loss, deduction, or credit, or if the allocation under the agreement does not have the substantial economic effect, the partner's share is determined according to the partner's interest in the partnership. (See section 704(b).)

Specific Instructions

(Schedule K only)

Enter the total distributive amount for each applicable items listed.

(Schedule K-1 only)

Prepare and give a Schedule K-1 to each person who was a partner in the partnership at any time during the year. **Schedule K-1 must be provided to each partner on or before the day on which the partnership return is required to be filed.**

Note: *Generally, any person who holds an interest in a partnership as a nominee for another person is required to furnish to the partnership the name, address, etc., of the other person.*

On each Schedule K-1, enter the names, addresses, and identifying numbers of the partner and partnership and the partner's distributive share of each item.

For an individual partner, enter the partner's social security number. For all other partners, enter the partner's Federal Employer Identification Number. (However, if a partner is an individual retirement arrangement (IRA), enter the identifying number of the custodian of the IRA. Do not enter the social security number of the person for whom the IRA is maintained.)

If a husband and wife each had an interest in the partnership, prepare a separate Schedule K-1 for each of them. If a husband and wife held an interest together, prepare one Schedule K-1 if the two of them are considered to be one partner.

Note: *Space has been provided after line 19 of Schedule K-1 for you to provide information to the partners. This space may be used in lieu of attachments.*

Question A.—Is This Partner a General Partner?

Question A must be answered for all partners. If a partner holds interests as both a general and limited partner, attach a schedule for each activity which shows the amounts allocable to the partner's interest as a limited partner.

Item B.—Partner's Share of Liabilities.

Enter each partner's share of nonrecourse liabilities, partnership-level qualified nonrecourse financing, and other liabilities. If the partner terminated his or her interest in the partnership during the year, enter the share that existed immediately before the total disposition. In all other cases, enter it as of the end of the year.

If the partnership is engaged in two or more different types of "at risk" activities, or a combination of "at risk" activities and any other activity, attach a statement showing the partner's share of nonrecourse liabilities, partnership-level qualified nonrecourse financing, and other liabilities for **each** activity. See sections 465(c)(2) and (3) to determine if the partnership is engaged in more than one "at risk" activity.

If a partnership is engaged in an activity subject to the limitations of section 465(c)(1), give each partner his or her share of the total pre-1976 losses from the section 465(c)(1) activity (i.e., film or video tape, section 1245 property leasing, farm, or oil and gas property) for which there existed a corresponding amount of nonrecourse liability at the end of each year in which the losses occurred.

Question C.—What Type of Entity Is This Partner? State on this line whether the partner is an individual, a corporation, a fiduciary, a partnership, an exempt organization, or a nominee. If the partner is a nominee, indicate the type of entity the nominee represents: I—Individual; C—Corporation; F—Fiduciary; P—Partnership; E—Exempt Organization; or IRA—Individual Retirement Arrangement.

Question D.—Partner's Profit, Loss, and Capital Sharing Percentages. Enter in item D(ii) the percentage existing at the end of the year. However, if a partner's interest terminated during the year, enter in item D(i) the percentages that existed immediately before the termination. When the profit or loss sharing percentage has changed during the year, show the percentage before the change in item D(i) and the end of year percentage in item D(ii). If there are multiple changes in the profit and loss sharing percentage during the year, attach a statement giving the date and percentage before each change. "Ownership of capital" means the portion of the capital that the partner would receive if the partnership was liquidated at year end by the distribution of undivided interests in partnership assets and liabilities.

Items F and G.—Federal Tax Shelter Registration Information. If the partnership is a registration-required tax shelter, it must enter its Federal Tax Shelter Registration Number in Item F and identify the type of tax shelter in the space provided in Item G. If the partnership invested in a registration-required tax shelter, the partnership must also attach a copy of federal Form 8271 to Schedule K-1. See federal Form 8271 for a list of the types of tax shelters and for more information.

Question J. Reconciliation of Partner's Capital Account. See page 6 of instructions for both "Filing a Complete Return" and Schedule M-2.

(Schedules K and K-1 unless otherwise noted)

Income (loss)

Line 1

Enter the partner's share of the ordinary income (loss) reported on Form N-20, line 22. If line 22 is a loss, enter the partner's full share of the loss. If the partner holds interests in the partnership both as a general partner and as a limited partner, enter the total loss for all interests held in the partnership. Enter the loss without reference to the adjusted basis of the partner's interest in the partnership or the partner's amount at risk. Line 1 should reflect the total ordinary income (loss) from all trade or business operations.

Line 5

Enter: (1) the guaranteed payments to partners for salaries and interest deducted by the partnership and reported on Form N-20, line 10; and (2) the guaranteed payments to partners that the partnership is required to capitalize. (See the note in the instructions for Form N-20, line 10.)

Line 6

Give each partner a schedule that separately shows each partner's share of the amount to be

reported on federal Form 4684, Casualties and Thefts.

Line 7

Enter any other items of income, gain, or loss not included on lines 1-6, such as:

- Gains from the disposition of farm recapture property (see Schedule D-1) and other items to which section 1252 apply.
- Recoveries of bad debts, prior taxes, and delinquency amounts (section 111).
- Gains and losses from wagering (section 165(d)).
- Any income, gain, or loss to the partnership under section 751(b).

Deductions

Line 8

Enter the total amount of charitable contributions, and each amount subject to the 50%, 30%, and 20% limitations paid by the partnership during the tax year. Attach an itemized list that separately shows the partnership's charitable contributions subject to the 50%, 30%, and 20% limitations.

If the partnership made a qualified conservation contribution under section 170(h), also include the fair market value of the underlying property before and after the donation, the type of legal interest contributed, and describe the conservation purpose furthered by the donation. Give a copy of this information to each partner.

Line 9

A partnership may elect to expense part of the cost (up to \$17,500) of recovery property that the partnership purchased this year for use in its trade or business. The partnership may not deduct the section 179 expense, but should report the expense separately on Schedules K and K-1. The partners report their shares in the year in which the property is placed in service. Show the total section 179 expense on Schedule K, line 9, and allocate it to each partner on Schedule K-1, line 9.

The partnership must specify the item(s) of section 179 property which it elects to treat as an expense and the portion of the cost of each item which is being treated as an expense. Do this on federal Form 4562, Depreciation and Amortization, and on a schedule attached to Schedule K-1. Generally, any election made under section 179 may not be revoked except with the consent of the Director.

Depreciation or amortization may **not** be taken on any amount for which a deduction is allowed under section 179.

See section 179 and federal Form 4562 for more information.

Line 11

Enter any other deductions not included on line 8-10, such as:

- Amounts, other than investment interest, paid by the partnership that would be itemized deductions on any of the partners' income tax returns if they were paid directly by a partner for the same purpose. These amounts include, but are not limited to expenses under section 212 for the production of income other than from the partnership's trade or business.
- Any interest penalty on early withdrawal of savings. The federal Form 1099-INT given to the partnership by a bank or savings and loan association will show the amount of any interest penalty the partnership was charged because it withdrew funds from its time savings deposit before its maturity.

c. Soil and water conservation expenditures (section 175).

d. Deduction and recapture of certain mining exploration expenditures paid or incurred (section 617).

e. Intangible drilling costs.

Credits

Line 12

Energy Conservation Tax Credit

On Schedule K enter the tax credit for solar or wind energy devices, heat pumps and ice storage systems computed by the partnership. This credit is computed at the partnership level. It is apportioned among the partners according to their interest in the partnership. On Schedule K-1 enter each partner's share of the credit.

Line 13

Total Cost of Qualifying Property for the Capital Goods Excise Tax Credit

A Capital Goods Excise Tax Credit is available for tangible personal property purchased and used in a trade or business in Hawaii. The amount of the tax credit allowable is 4% of the cost of the qualified tangible property. The tax credit is applied against a taxpayer's net income tax liability and if the tax credit exceeds the amount of the tax liability, the excess will be refunded to the taxpayer. See Form N-312A, Capital Goods Excise Tax Credit, for additional information.

Line 14

Fuel Tax Credit for Commercial Fishers

Enter the fuel tax credit for commercial fishers as determined by Form N-163A.

Line 15

Enterprise Zone Tax Credit

A qualified enterprise zone business is eligible to claim a credit for a percentage of taxes due the State attributable to the conduct of business within a zone and a percentage of the amount of unemployment insurance premiums paid based on the payroll of employees employed at the business firm establishments in the zone. The applicable percentage is 80% the first year; 70% the second year; 60% the third year; 50% the fourth year; 40% the fifth year; 30% the sixth year; and 20% the seventh year. This credit is not refundable and any unused credit may NOT be carried forward.

Partnership to prepare separate Form N-756A for each partner.

Line 16

Low-Income Housing Tax Credit

Hawaii's low-income housing tax credit is equal to 30% of the federal credit for qualified buildings located in the State of Hawaii. The federal credit must be claimed in order to claim the Hawaii credit. Attach Form N-586, Tax Credit for Low-Income Housing, to the partnership return.

Contact the Housing Finance Development Corporation for qualifying requirements and further information.

Line 17

Credit for Employment of Vocational Rehabilitation Referrals

The amount of the tax credit for the taxable year shall be equal to 20 percent of the qualified first-

year wages for that year. The amount of the qualified first-year wages which may be taken into account with respect to any individual shall not exceed \$6,000.

“Qualified wages” means the wages paid or incurred by the employer during the taxable year to an individual who is a vocational rehabilitation referral and more than one-half of the wages paid or incurred for such an individual is for services performed in a trade or business of the employer.

“Qualified first-year wages” means, with respect to any vocational rehabilitation referral, qualified wages attributable to service rendered during the one-year period beginning with the day the individual begins work for the employer.

The credit allowed shall be claimed against net income tax liability for the taxable year. A tax credit which exceeds the taxpayer's income tax liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted.

Refer to Form N-884 for further information.

Investment Interest

Line 18

Lines 18a-18b(2) must be completed whether or not a partner is subject to the investment interest rules.

Line 18a. Investment Interest Expense.—Include on this line interest paid or accrued to purchase or carry property held for investment. Property held for investment includes property that produces portfolio income (interest, dividends, annuities, royalties, etc.). Therefore, interest expense allocable to portfolio income should be reported on line 18a of Schedule K-1 (rather than line 10 of Schedule K-1).

Property held for investment includes a partner's interest in a trade or business activity that is not a passive activity to the partner and in which the partner does not materially participate. An example would be a partner's working interest in oil and gas property (i.e., the partner's interest is not limited) if the partner does not materially participate in the oil and gas activity.

Investment interest does not include interest expense allocable to a passive activity.

The amount on line 18a will be deducted (after applying the investment interest expense limitations of section 163(d)) by individual partners on their Form N-12 or N-15.

Lines 18b(1) and 18b(2). Investment Income and Expenses.—Enter on line 18b(1) only the investment income included on line 4 of Schedule

K-1. Enter on line 18b(2) only the investment expense included on line 10 of Schedule K-1.

If there are items of investment income or expense included in the amounts that are required to be passed through separately to the partner on Schedule K-1 (items other than the amounts included on lines 4 and 10 of Schedule K-1), give each partner a schedule identifying these amounts.

Investment income includes gross income from property held for investment, gain attributable to the disposition of property held for investment, and other amounts that are gross portfolio income. Investment income and investment expenses do not include any income or expenses from a passive activity.

Property subject to a net lease is not treated as investment property because it is subject to the passive loss rules. Do not reduce investment income by losses from passive activities.

Investment expenses are deductible expenses (other than interest) directly connected with the production of investment income.

Other

Line 19

If applicable, include a schedule listing each partner's share of: (1) the total taxes withheld under the partnership's name and reported on Form N-288A, Statement of Withholding on Dispositions by Nonresident Persons of Hawaii Real Property Interests; (2) any refunds claimed by the partnership on Form N-288C, Application for Tentative Refund of Withholding on Dispositions by Nonresident Persons of Hawaii Real Property Interest; and (3) the net amount of taxes withheld.

Analysis (Schedule K only)

Lines 20a and 20b

For each type of partner shown, enter the portion of the amount shown on line 20a of Schedule K that was allocated to that type of partner. The sum of the amounts shown on line 20b must equal the amount shown on line 20a. In addition, the amount on line 20a must equal the amount on line 9, Schedule M-1 (if the partnership is required to complete Schedule M-1).

In classifying partners who are individuals as “active” or “passive,” the partnership should apply the following rules:

1. If the partnership's principal activity is a trade or business activity, classify a general partner as “active” if the partner materially participated in all partnership trade or business activities; otherwise, classify a general partner as “passive.”

2. If the partnership's principal activity consists of working interest in an oil or gas well, classify a partner holding a working interest in the oil or gas well through an entity that does not limit the partner's liability as “active;” otherwise, classify the partner as “passive.”
3. If the partnership's principal activity is a rental real estate activity, classify a general partner as “active” if the partner actively participated in all of the partnership's rental real estate activities; otherwise, classify a general partner as “passive.”
4. If the partnership's principal activity is a portfolio activity, classify all partners as “active.”
5. Classify all limited partners and all partners in a partnership whose principal activity is a rental activity other than a rental real estate activity as “passive.”
6. If the partnership cannot make a reasonable determination as to whether or not a partner's participation in a trade or business activity is material or whether or not a partner's participation in a rental real estate activity is active, classify the partner as “passive.”

In applying the above rules, a partnership should classify each partner to the best of its knowledge and belief. It is assumed that in most cases the level of a particular partner's participation in an activity will be apparent.

Filing a Complete Return

You will be considered to have filed a complete return, and are **not** required to furnish Schedules L, M-1, and M-2, on page 4 of Form N-20, and item J on Schedule K-1 if you are not required to file such schedules with the federal Form 1065.

If you are not furnishing Schedules L, M-1, and M-2 because the partnership meets **ALL** of the tests prescribed by the federal Form 1065, check the appropriate box on page 4, Form N-20.

Schedules L, M-1, and M-2 (Form N-20)

Attach a copy of page 4 of federal Form 1065 to the partnership's Hawaii return (Form N-20).

Schedules O and P

Apportionment of Income Computation of Apportionment Factors

See the instructions for “Attributable to Hawaii” on page 4, under **Schedule K and Schedule K-1**.